

Submission to Ofcom first consultation on
proposed changes to BBC iPlayer

pact.

May 2019

Introduction

- 1) Pact is the UK trade association representing and promoting the commercial interests of independent feature film, television, digital, children's and animation media companies.
- 2) In 2017, the BBC was the largest PSB commissioner of the independent production sector at £453 million. However, the BBC external commissioning spend has declined from 2009 when it was £498 million and 2013 when it stood at £476 million.¹ This fall in external spend has resulted in a growing financial gap between the BBC's programme tariff (budget contribution) and the actual cost of the programme. A large proportion of the decline in spend on first-run originated spend has been mitigated by an increase in third-party funding, such as co-production arrangements, tax credits and deficit funding from production companies. The independent production sector has provided approximately £2.5 billion of UK and international marketplace deficit finance for PSB content production over the last ten years.
- 3) This deficit financing model applies to all the PSBs (BBC, ITV, C5 and C4) as producers are required to accept risk as part of the financing process of much of UK PSB content. In order to secure the necessary UK and international sales to bridge the financing and/or enable the producer to make a profit from the series (IP), producers are incentivised under this system to make the series as high quality as possible to maximise its potential exploitation. The Terms of Trade system, in which producers own the IP of programmes developed by their production companies, therefore benefits both the PSBs and the UK audience alike.
- 4) IP ownership and access to the UK and international markets has enabled the UK independent television sector to be transformed from a cottage industry in 2003 to one of the biggest in the world. In 2017, UK independent television sector revenues stood at £2.7 billion.² The UK TV Exports Report 2016 – 2017, showed that the UK television industry including the BBC and ITV Studios exported £902 million in TV programming and associated activities to the rest of the world. The UK is the second largest exporter of TV content in the world (after the USA) and the biggest international exporter of programme formats. The USA was the largest export market for the UK at £335 million with Australia, France, Germany and the Nordic countries completing the top 5 markets for the UK.³

¹ Pact Census 2018

² Pact Census 2018

³ Pact UK TV Export Report 2016 - 2017

- 5) As the content producers' trade association, Pact supports and promotes fair competition and marketplace innovation. Pact notes that Ofcom's 'Distribution of BBC Public Services: Ofcom's requirements and guidance' stated that the rise of new platforms and services, such as SVOD, have provided consumers with an "increasing choice in how they access TV content" and that "these developments have delivered significant benefits to society".⁴
- 6) Pact is a supporter of the BBC licence fee and recognises the critical role that the BBC plays in British broadcasting. Pact believes that there is a strong future for both the PSBs and the SVODs who can co-exist in a dynamic, competitive and innovative UK market that is open to competition.
- 7) Pact welcomes the opportunity to submit evidence to Ofcom's consultation on the BBC's planned changes to the iPlayer. Pact is seeking to persuade Ofcom to consider the key points of - c) Reduced value of secondary rights and d) Unfairly favour BBC Studios - in Section 5. Pact believes that both these issues are of material importance and should be factored into the assessment of market impacts.
- 8) For further information, please contact Pact's Interim Head of Policy, Niall Stewart, at niall@pact.co.uk or on 020 7380 8232.

Consultation Questions

1.1 What do you think of the BBC's proposals and the procedures it has followed in carrying out its PIT?

1.2 Pact has broken the question down into two parts. The first section below will outline Pact's views on the BBC proposals whilst the following section will provide Pact's view of the BBC's procedures in carrying out the PIT.

Pact View of BBC Proposals

1.3 Pact believes that the BBC's proposals are based on an inappropriate distribution rather than content strategy. Pact believes that the BBC should be providing more relevant content that appeals to a younger demographic of the UK audience. There is a careful balance to be struck between distribution and editorial, but the emphasis should be on original content.

BBC Proposals and Pact response

1.4 Change iPlayer from 'catch-up service' to destination viewing

⁴ Ofcom, 'Distribution of BBC Public Services: Ofcom's requirements and guidance', March 2017, 'Sector Context', Clause 3.6 and Clause 3.7

1.5 Pact would refute this proposal. The Communications Chambers report for the BBC found no evidence that this would be the outcome of the move to a minimum 12-months window. The report instead states that “the trial did not provide evidence of such a shift, but it is possible that extended windows for more content, on a permanent basis, would result in a change of perception and hence incremental usage”.⁵

1.6 Pact remains concerned that the BBC Board is still over-emphasising the competitive challenge from the SVODs at a time when 92% of the UK adult population still uses BBC services at least once a week.⁶ Pact believes that the evidence shows that the BBC’s linear television services remain the key destination for the BBC’s viewers.

12 Months Minimum iPlayer window

1.7 The BBC Public Interest submission document states that “12 months is a fundamental minimum to transforming BBC iPlayer and halting the decline in its share of viewing”

1.8 Pact notes that the BBC is seeking to have exclusive iPlayer content for a minimum of 12 months. The BBC’s use of the term ‘minimum’ is critical here. Pact is concerned that the BBC’s proposed 5-year exclusive window for children’s content is the preferred iPlayer period for the BBC. Pact believes that the BBC will impose the 5 year period or longer once the 12 month precedent has been established.

1.9 Pact would refute the rationale behind the BBC’s proposal as it is based on after-the-fact audience research and economic competition analysis that is intended to justify the BBC’s Board decision rather than provide independent and robust analysis of how the BBC should re-connect with younger audiences. Greater availability will not on its own bring in the audiences if the content offer remains unappealing to the 16-34-year audience demographic.

1.10 Judging by the BBC’s repetition of the fact that over 40% of UK households now subscribe to at least one SVOD provider⁷, Pact believes that the BBC has reached a misguided conclusion on why so many UK households are SVOD subscribers.

1.11 Pact believes that audience attention is secured by good content and not only by just changing distribution models. The BBC should be focusing on the fact that over 40% of the UK population primarily want the original content provided by these subscription services and are willing to pay for that privilege month after month. It is Pact’s belief that SVOD services have a dominant VOD share at the expense of the

⁵ “Report for the BBC Forecast of the viewing impact of proposed changes to BBC iPlayer, 16 April 201, Communications Chamber, Critical mass section, para 1, page 13)

⁶ Ofcom, Media Nations Report 2018

⁷ BBC iPlayer proposals: Public Interest Test consultation document, January 2019

BBC because of the quality of the SVOD content. This includes acquired PSB programming from the BBC amongst others.

1.12 Pact would recommend that the BBC can make its services destination viewing for all viewers by increasing the content spend for diverse and younger audiences across the UK. This could be achieved by the BBC reducing their anticipated yearly administrative spend of nearly £1 billion. This hasn't been helped by cost over-runs on the BBC EastEnders set and the costly failure of BBC Store. Other costly BBC commercial or administrative failures include the Digital Media Initiative and Lonely Planet write-off whose combined cost was some £178 million.

Enhance Public Value; Audience Demands

1.13 Pact would reject the BBC's audience survey findings on audience support for the iPlayer. The audience surveys bar one were commissioned after the BBC's minimum 12 months iPlayer window decision was made. The survey and focus groups relied on hypothetical questions to hypothetical scenarios which have inbuilt dangers of bias such as prompting. Shows that underperform on linear TV will underperform on iPlayer regardless of any extensions of the time period availability.

1.14 Pact believes that there will be marginal public value for the audience as the baseline improvement of the iPlayer viewing figures are 1.9 minutes per person per day. Pact notes that this headline figure is an average and for some viewers, the additional viewing time may be even less. Pact doubts whether this additional viewing time will add much to the fulfilment of the BBC's mission to inform and entertain the diverse public.

1.15 The BBC's audience survey findings also seem contrary to the continuing popularity of linear TV in the UK. Linear TV still dominates the UK audience's daily video viewing habits with 173 minutes a day in 2016. In comparison, the total for VOD viewing stood at 25 minutes. Broadcast TV still holds the biggest share of people's viewing habits as it makes up 71% of people's total daily TV and audio-visual viewing in 2017. The PSBs continue to dominate linear TV viewing with a 70% market share.⁸

Complementary to Commercial PSB services

1.16 Pact notes that the BBC's research found little change to the subscription levels for the SVODs but the BVOD services of My5 and All4 as well as the SVOD service NOW TV would show the greatest loss of usage from the audience. This means that the BBC will be largely cannibalising audiences from the commercial PSBS VOD

⁸ BBC Media Centre, 'BBC publishes Annual Report 2017/18', July 2018, available at: <https://www.bbc.co.uk/mediacentre/latestnews/2018/annual-report> and Ofcom, 'Media Nations Report 2018'

services. Pact believes that the BBC's planned iPlayer changes will damage the commercial PSBs and will not lead to any additional public value.

Market Impact

1.17 The BBC states in their BBC Public Interest Test submission document that "even if increasing the availability of programmes on BBC iPlayer were to lead to a reduction in future commercial revenues, in a competitive market, a reduction in the value of the secondary window could, all other things being equal, lead to an increase the price of primary commissions".⁹

1.18 Pact believes that there will be a considerable damaging market impact as a consequence of the BBC's iPlayer changes. This is detailed in depth in Annex A. Pact would reject the BBC's assurances on increases of the primary commission as the BBC Annual Plan, which was published in March 2019, makes no reference to the likely rise of BBC tariffs for its external programme commissions. The BBC has also made it clear in the Public Interest Test submission document that the minimum 12 months iPlayer window will be covered by the current primary commission terms.

1.19 Pact notes that the Pact Census of 2018 found that the BBC remains the largest commissioner of original UK content with 50% of PSB commission spending and over 30% of all UK commissioning. For children's content, the BBC share of PSB spending rises to 95%. The BBC is also the biggest commissioner of small and medium sized companies in the UK accounting of 62% of PSB spending with companies of £5 million turnover and less. These companies tend to make mid-budget range factual and scripted content which is largely focused on the UK market.¹⁰ Buyer power will ensure that the BBC will be able to dictate to independent production companies the tariff for each commission regardless of any decline in the value of either UK secondary rights or international rights following the BBC's introduction of the minimum 12 months iPlayer window. The Annex A O&O report found that this is strengthened by the high degree of network differentiation in the UK. This means that the PSB channels focus on a particular demographic skew and have individual approaches to programming and spend per hour. This means that there are – at most – two buyers for a particular project. The UK PSB system also means that once a PSB and a company are in negotiations for a commission, rival broadcasters typically lose interest. The consequences of the BBC's extended 12 months minimum window on the same tariff terms will be to reduce production companies' profit margins. The effect of this will be to stifle innovation and reduce investment in the programme supply market. This is outlined in greater detail in Annex A.

⁹ BBC iPlayer Public Interest Test, April 2019, paragraph 221

¹⁰ Annex A, O&O report entitled 'Proposed changes to the BBC iPlayer: supporting Pact's response to Ofcom's call for evidence, May 2019, Section 3.1.1

1.20 Pact notes that the BBC Public Interest Test document asserts that “the proposed model of a new standard period of availability and then a mechanism for buying further BBC iPlayer availability beyond has been tried and tested with BBC Three and demonstrated as a working model, beneficial for audiences and positive at driving revenues for producers”

1.21 Pact would reject this statement as it is contrary to Pact’s empirical research of the online content market. In January 2019, Pact commissioned independent media consultancy, Mediatique, to review the commercial opportunities in online-only and short form content (SFC) for independent producers. Their empirical research interviewed independent content producers on the business practices of the PSBs including BBC Three which commissioned both long and short form content (SFC). The report stated that 30% of BBC Three’s commissions were SFC. Mediatique reported in the report’s executive summary that the “commercial relationship between producers and commissioners (characterised by low tariffs and limited sharing of income from secondary windows) had an inhibiting impact on overall market development and size.” The report also noted that the BBC demanded ownership of all back-end rights and offered poor SFC tariffs. This empirical market research makes it hard for Pact to understand how the BBC believes that BBC Three is a positive way forward for independent producers. Please note that the Mediatique report will be provided to Ofcom on request.

1.22 For a full assessment of the full market impact of the BBC’s planned iPlayer changes, please see Annex A. This is a separate attachment to the Pact submission and comprises of an O&O report which is entitled ‘Proposed changes to the BBC iPlayer: Supporting Pact’s response to Ofcom’s call for evidence’.

Pact Review of BBC PIT Procedures

1.23 Pact would also wish to query the procedures followed by the BBC in conducting the Public Interest Test. A number of concerns about the methodology of the BBC in assessing the Public Value of its proposals are also raised in Pact’s response to Ofcom’s Question 4.1 (Ofcom numbering).

1.24 Pact notes that the BBC has only published its research and analysis report on the iPlayer changes after the Public Interest Test has finished its consultation phase. This means that independent stakeholders such as Pact, have had no opportunity to test how the data was collected and analysed in the Frontier Economics or the Communications Chambers reports. This was because the audience surveys to accompany the BBC Public Interest Test were not commissioned until January 2019. An earlier December 2018 survey was self-selecting which means that the poll has no weighting to eliminate bias.

1.25 This is why Pact appreciates the opportunity to comment on this process to Ofcom in this consultation as we are concerned that many of the BBC assessments and conclusions are not based on sufficiently robust commercial and audience data.

Pact notes that the BBC has decided upon the 12-month minimum window without any direct consultation with the wider market, suppliers or competitors who may be impacted by the BBC's planned changes. The BBC's post-decision consultation, which took the form of the Public Interest Test, has generated broadly negative responses from industry stakeholders such as Sky, Virgin Media, COBA and Pact. Virgin Media shared Pact's concerns about a lack of content strategy for younger audiences.¹¹ Sky noted that the BBC is currently involved in a number of other changes to the wider sector, including the division of the UKTV joint venture assets between BBC Studios and Discovery and Britbox, and they fail to give any explanation of how these plans will fit with its public service activities, BBC iPlayer.¹² COBA notes that the BBC fails to take into account that their proposals will likely raise demand for VOD, thereby increasing the pressure on other linear players.¹³ Pact is unable to assess the views of both ITV and C4 whose responses have not been published.

1.26 Pact notes that the BBC's Communications Chambers analysis of the MTM audience surveys on the BBC's planned iPlayer changes found that the plans will bring about an additional 1.9 minutes per person per day of BBC viewing. Pact believes that this information should have been available for the BBC Public Interest Test consultation. This is because stakeholders would have been in a position to compare the considerable harms of the BBC's planned changes to both the BBC and the wider UK production and broadcasting ecosystem.

1.27 Considering the importance of the BBC's planned iPlayer changes to the UK production and broadcasting ecosystem, Pact would like clarification on why this background research and data was not published either before the Public Interest Test consultation deadline, or indeed in conjunction with the Frontier Economics report 'Changes to BBC iPlayer: Competition Assessment' or the Communications Chambers report which were both published in April 2019.

1.28 Pact is also concerned that many of the questions in the BBC's Public Interest Test consultation document were skewed to provide the BBC with a positive response to their planned changes. For example, Question 1 was phrased to ensure that respondents agreed with the BBC Board's planned changes to the iPlayer by emphasising such terms as "potential public value" and "our proposals contribute to the BBC's mission". Question 2 was similarly skewed to ensure a positive reply by asking about "the benefit to consumers who will use this service".

1.29 Pact also notes that the weakness of the BBC audience surveys in terms of modelling future audience behaviour was acknowledged in the Frontier Economics Report. The report acknowledged in Annexe B.3 that "all surveys are necessarily imperfect mechanisms to understand future outcomes". The report also flagged up

¹¹ Virgin Media response: BBC iPlayer proposals Public Interest Test (PIT), p4

¹² Sky's Response to BBC Public Interest Test consultation on proposals for BBC iPlayer, p8

¹³ Response from the Commercial Broadcasters Association to the BBC Public Interest Test consultation, p6

the hypothetical nature of the survey which asked consumers to “posit what their hypothetical response would be to a number of hypothetical changes” that could be made to a service that they use. The report noted that the survey questions were framed to skew consumers to favour the planned changes. The report also commented on the dangers of various forms of bias to the survey and the problems of eliminating bias through weighting the responses. The report concluded that there is no “scientific way to weight the response to interpret data” because the chosen approach depends to a certain degree on judgement. Further analysis of the weakness of the BBC’s audience surveys and thus the conclusions of the Communications Chambers report can be found in Annex A and the accompanying O&O report.

1.30 Pact is also concerned that the Frontier Economics report makes a number of assertions and conclusions which do not appear to be substantiated by any accompanying empirical evidence. The Frontier Economics report states that “analysis conducted by Frontier Economics and based on BBC data has estimated the impact that increasing the availability of content on BBC iPlayer has on revenues earned in secondary markets ... [and found] that availability of BBC iPlayer had a positive “spill over” impact on the revenues earned in related markets”.¹⁴ Pact notes that this assertion is completely contrary to empirical evidence gathered from Pact’s member companies who stated that the value (revenues) of the secondary rights will – at best – be eroded or at worst, reduced to zero by the BBC’s planned iPlayer changes.¹⁵

1.31 Pact notes that the BBC asserts in the Executive Summary that the “analysis validates the BBC Board’s initial conclusion that the planned changes to BBC iPlayer are not material” and “any impact on fair and potential competition is likely to be outweighed by the substantial public value that our proposals will generate”. As stated earlier, Pact notes that the BBC’s conclusions appear to be based on Frontier Economics analysis which lacks any basis in empirical evidence from the market. This is because Frontier Economics states that their analysis is based on BBC data. Pact notes that the data is based on the performance of 108 BBC titles over the last ten years. Information on these 108 titles is limited in terms of genre for example. It is also important to note here that genres generate different revenues such as between drama and current affairs. This data could also be challenged as it potentially incorporates DVD title sales whose subsequent value could have collapsed with the rise of the VOD market. In 2017, home entertainment – physical, which covers DVD and video, was only 2% of the £480m revenues from UK TV content rights.¹⁶ Pact also notes that the market assesses each programme’s secondary and international market value by individual title rather than collectively. The value also varies year by year due to market fluctuations, brand, genre type,

¹⁴ Frontier Economics, Changes to BBC iPlayer: competition assessment, April 2019, p89 section 6.3.2

¹⁵ O&O, The Impact of BBC iPlayer Proposals on Production Finance: a report for Pact

¹⁶ Pact Census 2018, p25

changing audience preferences, talent valuation and a host of complex UK and international market factors. Without access to the BBC's data that underpins the Frontier Economics report, Pact cannot verify whether it is robust enough to justify the BBC's proposals and market conclusions. Pact notes that this commercially sensitive data can be accessed by Ofcom under the current regulatory framework.

1.32 Pact notes that the BBC asserts in the BBC Public Interest Test submission document that "independent producers will continue to make commercial decisions about the way that they commercially distribute their programmes during the BBC's licence period and beyond".¹⁷ This is again not accompanied by any empirical evidence or references. The BBC fails to take into account their buyer power over small and medium sized companies which tend to produce UK focused content for the UK PSBs. The BBC also refuses to acknowledge that UK VOD rights are disproportionately valuable and are often a key component of any global or multi-market deal negotiations. In a report prepared by O&O for Pact, O&O heard an anecdotal example where a deal for a series had been agreed in 24 markets, but the UK rights were not available. The deal would not have gone through without the UK rights, it was fortunate that the BBC acknowledged this and accepted a reduced holdback. If the iPlayer proposals are to take place, this gives the BBC extended leverage from the start which would make these types of negotiations impossible.¹⁸

1.33 The BBC argues in paragraph 119 of the BBC Public Interest Test submission document that BBC Three was a successful model for the planned changes as "increasing content availability on BBC iPlayer for audiences whilst enabling producers to generate sales revenues in the UK market and around the world". There is again no empirical evidence in support this BBC claim and the BBC statement contradicts Pact's empirical evidence from Mediatique. The Mediatique findings are outlined in Pact's earlier response to the question on the BBC's proposals

1.34 Pact cannot understand why the BBC has chosen to go ahead with the changes when the benefits in terms of increased audience reach will be so small of 1.9 minutes per person per day. Pact believes that this fails the public value test by failing to bring a tangible benefit to the BBC's mission of informing or entertaining the public or in terms of justifying the adverse impact on the BBC competition by cannibalising the audiences for the commercial PSBs VOD services. Pact is concerned that the BBC will target Channel 4 in particular as the BBC's Frontier Economics report has identified that All4 has a strong following amongst the target 16-34 year age group. For example, the BBC could seek to undercut Channel 4's most popular comedy series by launching major iPlayer boxset releases of popular comedy shows at the same time as new series premieres on Channel 4. This could

¹⁷ BBC iPlayer proposals: Public Interest Test consultation document, January 2019, paragraph 118

¹⁸ O&O, The Impact of the BBC iPlayer proposals on production finance, 2019,

result in the loss of a key audience for Channel 4 and impact on its advertising revenues.

1.35 Pact would contrast the BBC's iPlayer Public Interest Test with the BBC's evidence-driven consultation on the future of the Over-75s licence fee concession. The latter review was accompanied by research and analysis from Frontier Economics, which researched and analysed a number of the options available to the BBC in a very detailed manner. On that occasion, Pact felt able, on the basis of the detailed evidence, to come to the view that the concession should not be the responsibility of the BBC, but rather the Government and Parliament.

2.1 What are your views on the BBC's assessment as set out in its PiT? Do you agree with its conclusions?

2.2 Pact has brought together the BBC's assessments and conclusions and divided them into sections on:

- a) Policy Objectives,
- b) Lack of Freedom of Action,
- c) Business Models Disruption
- d) Audience Consumption

a) Policy Objectives

2.3 The BBC's intention is to change the view of iPlayer simply being a catch-up service to more of a 'destination', like Netflix.

2.4 Pact notes that the Communications Chambers research provides no evidence of the BBC achieving this objective and only states that it is possible. The Communications Chambers report states that "the trial did not provide evidence for such a shift, but it is possible that extended window for more content, on a permanent basis, would result in a change of perception and hence incremental usage."¹⁹

2.5 The BBC Public Interest submission document states that "12 months is a fundamental minimum to transforming BBC iPlayer and halting the decline in its share of viewing. 12 months is necessary to ensure a reliable, consistent offer across all content, in particular. Bolder commissioning decisions to enable more ambitious shows that may underperform in a linear schedule, but would deliver value over 12 months on BBC iPlayer".²⁰

2.6 Pact notes that the BBC doesn't provide any reason why the minimum 12 months window was the time-period decided upon by the BBC Board in 2018. The

¹⁹ Communications Chamber, Forecast of the viewing impact of proposed changes to BBC iPlayer, 2019, p13

²⁰ BBC iPlayer Public Interest Test, April 2019, para 22, page 9

BBC also fails to provide evidence on why they believe that shows that 'underperform' on linear with target audience groups such as the 16-34 year olds would do well on iPlayer.

2.7 The BBC states in their BBC Public Interest Test submission document that "even if increasing the availability of programmes on BBC iPlayer were to lead to a reduction in future commercial revenues, in a competitive market, a reduction in the value of the secondary window could, all other things being equal, lead to an increase the price of primary commissions".²¹

2.8 Pact notes that the BBC does not quantify the increase in the price of primary commission. The key word in the BBC statement above is the word "could".²² The BBC's Annual Plan 2019/20 makes no mention of this likely additional cost in their spending forecasts²³ In addition, Pact notes that their BBC Public Interest Test submission document asserts that "any costs associated with the proposed changes would be a very small proportion of the BBC's overall content spend budget for television of £1,612m for 2019/20".²⁴

2.9 Pact holds the view the BBC's buyer power in terms of its external content spend and as the biggest commissioner of small and medium sized companies will mean that the BBC will introduce the minimum 12 months iPlayer window as an exclusive licence term for no additional fees.

b) Lack of Freedom of Action

2.10 The BBC states in their Public Interest Test document that "For new commissions from independent producers, we are constrained by the terms of the business framework we negotiate with rights holders".²⁵

2.11 Pact notes that this business framework was established by the 2003 Communications Act which established the need for Terms of Trade to exist between the PSBs and the independent production sector. These Terms of Trade have evolved since their introduction in 2004. This means that each PSB has their own Terms of Trade with Pact to suit their particular business model. In 2018, Pact reached agreement with both ITV and C5 on a revision to their Terms of Trade. Pact notes that Pact and the BBC have reached agreement in the past to allow the launch of the iPlayer in 2007 and BBC Store which had a download model.

²¹ BBC iPlayer Public Interest Test, April 2019, paragraph 221

²² *ibid*

²³ BBC Annual Plan, 2019/20, published March 2019

²⁴ *Ibid*, paragraph 159

²⁵ BBC iPlayer Public Interest Test, April 2019, p33, paragraph 110

2.12 The BBC states in their Public Interest Test document that “Given that analysis clearly shows that our proposals are unlikely to have significant impact on competition and consumers, we do not consider there is robust justification to continue to set arbitrary limits around the volume and duration of content on BBC iPlayer.”²⁶

2.13 Pact notes that there are no arbitrary regulatory limits on the volume and duration of content on BBC. There are also no limits around the volume of content on the BBC. The BBC are within their rights to commission more content or acquire more content in return for a commercially negotiated price.

2.14 The BBC states that in the Public Interest Test document that “Given the speed of change, any limits placed on BBC iPlayer quickly become out of date and need to be replaced. More fundamentally, if these limits required regulatory approval to change, they would uniquely disadvantage the BBC in a competitive market, and therefore represent a significant risk to the BBC being able to adapt and meet its Mission and deliver the Public Purposes.”²⁷

2.15 The BBC Public Interest Test document states that – “we consider that our proposals are the minimum necessary to achieve our mission and deliver the public purposes.”²⁸

2.16 Pact has been presented with proposals by the BBC that show that the minimum 12 months window is the first step to a much longer iPlayer licence. The BBC has already stated publicly that children’s content will be covered by a five-year iPlayer window

c) Audience Consumption

2.17 The BBC blames the fall of its VOD share from 40% in 2014 to 15% in 2018 due to audience exasperation at the lack of content access on iPlayer.²⁹ The BBC later asserts that “Succeeding is not just about the programmes we commission, and the way we market them, but also how we get them to our audiences.”³⁰

2.18 Pact notes that these assessments are contradicted by the BBC’s own reports. The Communications Chambers report states that usage of new scripted content declines between the second and third month on the iPlayer. There is no justification for a 12-month iPlayer window as usage nears zero percent by month 6 in what the Communications Chambers describes as a ‘decay curve’.³¹ Pact believes that the rise in the SVOD share of the market is not driven by considerations of access or

²⁶ Ibid, paragraph 109

²⁷ BBC iPlayer Public Interest Test, April 2019, p33, paragraph 112

²⁸ BBC iPlayer Public Interest Test, April 2019, p69, paragraph 243

²⁹ BBC iPlayer Public Interest Test, April 2019, p19, paragraph 16

³⁰ BBC iPlayer Public Interest Test, April 2019, p19, para 18

³¹ Communications Chamber, Forecast of the viewing impact of proposed changes to BBC iPlayer, 2019, p10, figure 6

availability as the SVODs content must be paid for monthly by the UK audience whilst the iPlayer content is offered for free. The difference must be the type of content offered by SVODs.

2.19 Pact believes that the statement offered by paragraph 18 of the BBC submission shows that the BBC has adopted a distribution rather than content led strategy. Figure 13 in the BBC Public Interest Test submission document shows that the 16-34 age group primarily use subscription streaming services to browse for new content. The top four reasons for SVOD usage indicate that this age group wants new original content that appeals to them and their friends. Pact also notes from the table that a 12-month iPlayer window comes second to last in the reasons behind the 16-34 year age group use of the BBC iPlayer. The most important 'ease of access' windows are shown to be for the first week or month after linear TV transmission.

2.20 The BBC Public Interest document asserts that ““One of reasons that other on-demand services are able to offer significantly more content than BBC iPlayer is that they have much longer availability of content.”³²

2.21 Pact believes that this is not due to SVOD's longer period of content availability but the consequence of the SVOD's much greater content budgets for acquisition and production. Netflix has a content budget of £6.1 billion which is much greater than the BBC's Network TV spend of £1.57 billion.³³ Netflix's content budget is paid for by their 139 million customers' subscriptions.³⁴ The SVOD companies maximise their spend on content acquisition and production because their subscription business model relies on attracting and retaining audiences through the provision of original premium content. These companies have also been able to minimise their operating costs in order to direct the maximum possible spending towards content.

2.22 Pact further notes that Netflix do not release their viewing figures. It's possible that content that has been available on Netflix for long periods of time is watched by very few people.

2.23 Figure 5 (p16) in the Public Interest Test document shows the total hours across the main five TV genres by service. Although iPlayer has a lower number of hours than Netflix, Amazon, Now TV and All 4, it is larger than ITV Hub. All 4 has a much larger range of content as it buys content from overseas or acquires older series. The BBC fails to take this into account in their assertions or conclusions.

³² ³² BBC iPlayer Public Interest Test, April 2019, p33, p16, paragraph 51

³³ The Guardian, Netflix hunts long-term UK production base amid race for studios, 14/9/2018, available at: <https://www.theguardian.com/media/2018/sep/14/netflix-hunts-long-term-uk-production-base-amid-race-for-studios>

³⁴ CNN, 'Netflix adds 9 million paying subscribers, but stock falls', 18/1/2019, available at: <https://edition.cnn.com/2019/01/17/media/netflix-earnings-q4/index.html>

d) Business Models Disruption

2.24 The BBC Public Interest Test submission document states that the Frontier Economics analysis “did not support the premise that lengthening the availability of programmes on BBC iPlayer reduces producers’ ability to generate commercial revenues in the UK. In fact, it suggested the opposite – i.e. that producers are able to achieve higher commercial revenues in the UK when the series is shown on BBC iPlayer for longer”.

2.25 Pact notes that this analysis completely ignores evidence from Pact’s member surveys research, which was conducted by independent media consultancy O&O which found that the BBC’s planned iPlayer changes would seriously disrupt independent production companies’ ability to access finance from the international and UK secondary rights markets. Please see Annex A for the full O&O report.

2.26 Pact notes that Frontier Economics qualifies their analysis by stating that the data is provided by the BBC. Pact notes that this data is not referenced by Frontier Economics which must mean that the data is not publicly available and so is not available for independent analysis.

2.27 Pact notes that the BBC’s BBC Public Interest Test submission document provides some information on this BBC data. The submission document explains that Frontier Economics based their models on the “availability of content on BBC iPlayer and the value of the content in secondary rights markets based on an analysis of 108 series that were first broadcast by the BBC between 2008 and 2017.”³⁵ Pact would respond that this BBC data should be open to independent and robust analysis and verification by independent stakeholders.

2.28 The BBC Public Interest Test submission document asserts that “of the BBC network hours in 2018 that were commissioned from indie producers, over half were fully funded by the BBC.”³⁶

2.29 Pact would respond that the BBC fully funds programmes which have NO secondary rights value. Pact also notes that this statistic is NOT broken down by the BBC in terms of genre. Some genres have no or limited secondary rights value whilst others have much greater value in the secondary rights market such as mid-range drama and comedy. This value is dependent on a number of factors, but the BBC’s 12-month free iPlayer window will ensure that all content is of limited or no value to either SVOD providers or UK multi-channel companies. The report in Annex A notes that BBC Studios will be the full owner of a major buyer of secondary UK rights in UKTV and the BBC is the co-founder of another potential major buyer of such rights in Britbox. As stated earlier, O&O also found that the inclusion of UK SVOD rights can be critical for a global SVOD sale.

³⁵ BBC iPlayer Public Interest Test, April 2019, p63, paragraph 219

³⁶ Ibid, p62, paragraph 216

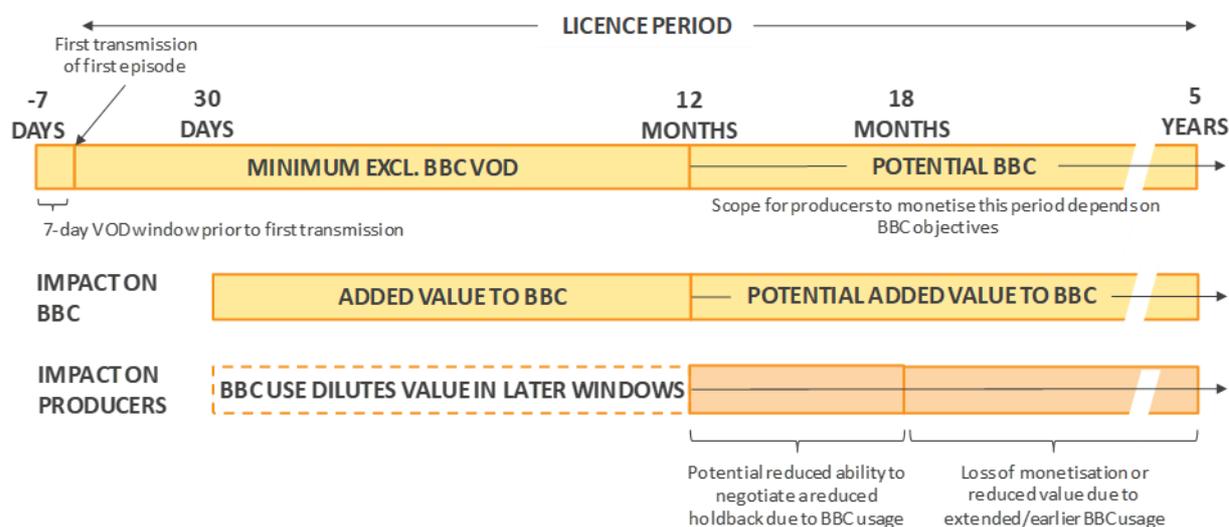
2.30 The BBC Public Interest Test document asserts that “of the programmes that do generate revenues from the secondary TV and SVOD markets in the UK, a number of programmes (particularly in drama) fully recoup their upfront investments from international revenues.”³⁷

2.31 Pact would respond that this assertion regarding producers’ recoupment is based on relatively few high-end drama programmes. High-end drama is also dominated by BBC Studios and the larger independents. High-end dramas in the UK also qualify for a tax credit which helps producers in completing the programme budget. Other tax credits are available for children and animation programmes. With high-end dramas, there is also likely to be major talent attached to the series such as director or cast which have proven value in the international television market. The O&O report noted that “the global appeal of high-end drama means that such programmes may be able to cover their budget with international sales as well as through alternative sources such as co-production finance”.

2.32 The BBC submission concludes that “the BBC does not control the IP of a large proportion of the content it distributes and therefore cannot restrict its supply”.³⁸

2.33 Pact would refer to Figure 6 of the O&O report which is shown below. This outlines the impact of the BBC changes on the content’s monetisation timeline.

2.34 This timeline shows that the BBC can prevent any use of the content for 18 months after the BBC’s linear transmission and 30-day iPlayer window. This is called the holdback period.



2.35 Pact notes that the introduction of the minimum exclusive 12 months iPlayer window will ensure that the BBC will be able to restrict the supply of BBC-

³⁷ BBC iPlayer Public Interest Test, April 2019, p62, paragraph 216

³⁸ Ibid, p64, paragraph 224

commissioned IP content to UK multi- channels and SVOD services during this holdback period.

2.36 The O&O report observes that “since the value of secondary rights typically decreases over time, the BBC would be taking the most valuable time period and thus could significantly impact the value of the secondary rights available for producers to monetise”. This reduction in value, which is due to the BBC’s exploitation of the content for much longer than the current window, will reduce the possibility of a sale to either SVODs or multi-channel companies and so restrict the content’s distribution and supply to the market. There is also the question of exclusivity of the content over the 12-month minimum window. This is dealt with later in this submission and in Annex A.

3.1 Do you have any comments or other views on how the audio-visual sector has evolved or is likely to evolve in the future that we should consider?

3.2 Pact would refer Ofcom to the timeline in the Frontier Economics report.³⁹ This shows that the UK PSBs including the BBC are able to innovate and introduce new services to the UK audience under the current Ofcom regulatory framework and Terms of Trade.

3.3 The BBC Frontier Economics report also notes that both ITV and Channel 5 have been able to change their VOD offerings to the public through commercial negotiation with Pact in order to amend the Terms of Trade. These agreements were concluded in 2018.

3.4 For example, Pact’s deal with ITV has recently been updated following constructive negotiations between the two parties. ITV remunerates producers for all VOD uses and, subject to negotiation, ITV’s VOD rights are not necessarily exclusive.

3.5 The SVODs have proven – by virtue of their increasing production spend in the UK with the BBC and the independent production sector – that they will be a positive force in the UK’s media landscape. Pact notes that the BBC has led the way with SVOD collaborations. These co-production partnerships enable the BBC to provide high-end dramas to their audiences for a fraction of the actual cost.

3.6 Pact believes that the UK production and broadcasting ecosystem is robust and underpinned by the Terms of Trade which both protects UK plc’s ability to retain IP in the UK and facilitate innovation by the PSBs to maximise their reach to the UK audience and revenues from the sale of such content.

³⁹ Frontier Economics Report, ‘CHANGES TO BBC IPLAYER Competition assessment’, Box headlined “BBC IPLAYER HAS ITERATIVELY INNOVATED TO MEET CHANGING DEMAND AND TECHNOLOGICAL ADVANCES’, page 31)

3.7 Pact believes that the BBC's iPlayer objectives would be best achieved – without harm to the UK's production and broadcasting ecosystem – through constructive negotiation with Pact on behalf of the UK independent production sector.

4.1 Do you have any views or evidence on how viewing of individual programmes changes over time on VOD services?

4.2 Pact is unable to provide views or evidence on this question due to the time constraints of the two-week consultation deadline. This means that Pact does not have the time to commission the necessary market research to properly address this question.

5.1 Do you have any views or evidence on how UK VOD viewing might evolve in the future, including viewing on individual services or total levels of viewing?

5.2 Pact is unable to provide views or evidence on this question due to the time constraints of the two-week consultation deadline. This means that Pact does not have the time to commission the necessary market research to properly address this question.

6.1 What are your views on the methodology and conclusions of the BBC's assessment of public value generated by the proposals?

6.2 Pact has broken this question down into two parts. The first section will review the BBC's methodology in its assessment of the public value of its proposals.

6.3 The second section will be Pact's view of the BBC's conclusions.

Methodology Review

6.4 Pact notes that the BBC bases its assessment of the public value of its proposals to the UK audience following audience research by MTM, modelling by Communications Chambers and an online self-selecting survey conducted by the BBC in December 2018.

6.5 Pact holds the view that the methodology pursued by the BBC is extremely flawed.

6.6 The BBC cited an online self-selecting survey as one source of audience research which was conducted before the consultation was launched in January 2019. This research was conducted in December 2018 which is after the BBC Board had decided upon the 12-month minimum window for the iPlayer. Self-selecting surveys are worthless for the possibility cannot be discounted that those surveyed are all BBC employees.

6.7 It is clear from Annex 1: Research and analysis of the BBC's Public Interest Test submission document that the BBC Board's adoption of the 12-month minimum window for the iPlayer was adopted without any authoritative independent research.

6.8 The research commissioned by the BBC in January and February 2019 was therefore undertaken to support the BBC Board's decision rather than provide independent and impartial studies to establish the UK audiences' views of all the BBC services including the iPlayer. Pact notes that the weakness of the BBC audience surveys in terms of modelling future audience behaviour was acknowledged in the Frontier Economics Report. The Frontier report stated in Annex B.3 that "all surveys are necessarily imperfect mechanisms to understand future outcomes". The report also flagged up the hypothetical nature of the survey which asked consumers to "posit what their hypothetical response would be to a number of hypothetical changes" that could be made to a service that they use. The report noted that the survey questions were framed to skew consumers to favour the planned changes. The report also commented on the dangers of various forms of bias to the survey and the problems of eliminating bias through weighting the responses. The report concluded that there is no "scientific way to weight the response to interpret data" because the chosen approach depends to a certain degree on judgement.

6.9 These skewed questions could also be found in the BBC's consultation document. Pact was concerned that much of the questions in the BBC's Public Interest Test consultation document were skewed to provide the BBC with a positive response to their planned iPlayer changes. For example, Question 1 was phrased to ensure that respondents agreed with the BBC Board's planned changes to the iPlayer by emphasising such terms as "potential public value" and "our proposals contribute to the BBC's mission". Question 2 was similarly skewed to ensure a positive reply by asking about "the benefit to consumers who will use this service".

6.10 Pact also notes that the analysis conducted by Frontier Economics was based on the data for 108 titles over the last ten years. Pact would note that this BBC data fails to take into account two key commercial factors.

6.11 Firstly, the data for these titles shows their past market value and historic viewing figures. The data also includes the titles' DVD value. Ofcom should note that the DVD values have plummeted due to the rise of the SVOD market. Empirical research from media consultancy O&O shows that SVODs place a premium on UK content for the UK market. The O&O report noted that the inclusion of UK SVOD rights are critical for a global SVOD sale.

6.12 The second factor is that the market treats every programme differently so the market performance of one title is no guide to the performance of another programme.

Conclusions Review

6.13 Pact does not accept that due to the BBC's audience and competition research and analysis that the BBC's assessment on the Public Value of its planned changes is reasonable.

6.14 Pact's conclusions review has two sections. One section is for Personal and Social Value and the other is for Additional Public Value.

Audience (Personal and Social Value)

6.15 Pact notes that the BBC concludes that the changes to the iPlayer would lead to the following benefits.

6.16 The BBC argues that the changes will represent better value for money for the licence fee. In paragraph 40, the BBC Public Test document stated that there would be a 29% increase due to introduction of the 12-month iPlayer window. Pact would query that there is value for money for this is 1.9 minutes per person per day. With such a minimal rise in audience usage, Pact would query the BBC's conclusion that it will help users to access more educational and factual content.⁴⁰ Pact notes that Figure 18 in the BBC Public Interest Test document shows that accessibility to content for a year does not factor in the top three reasons why all adults would use the iPlayer service following the introduction of a 12 months minimum window.

6.17 Paragraph 148 of the BBC Public Interest Test states that the changes to the iPlayer will better enable the BBC to reflect and represent everyone in the UK. This is again a question of content rather than iPlayer distribution.

6.18 The BBC states that "63% of people surveyed would be more likely to browse iPlayer for new programmes (after the changes)." However, Pact notes that browsing for programmes doesn't mean that users will actually watch the programmes.⁴¹

6.19 The BBC concludes that 46% of all respondents would watch the iPlayer more because of the planned changes. However, Figure 20 of the BBC Public Interest Test submission document shows that 50% of 16-34 year olds probably or definitely won't start to use the iPlayer following the changes with only 26% of this age group promising to watch more as a consequence of the BBC's planned changes.

6.20 Figure 13 in the BBC Public Interest Test document shows clearly that the most important reason for 16-34 age group using subscription streaming services is to browse for new content. The top four reasons for SVOD usage indicate that this age group wants new original content that appeals to them and their friends. Pact also notes from the table that a 12-month iPlayer window comes second to last in the reasons behind the 16-34 year age group use of the BBC iPlayer. The most

⁴⁰ BBC iPlayer Public Interest Test, April 2019, p44, paragraph 148

⁴¹ BBC iPlayer Public Interest Test, April 2019, p41, paragraph 139

important ease of access windows are shown to be for the first week or month after linear TV transmission.

6.21 This is borne out by the BBC's Communications Chambers report for the BBC which showed that viewers' interest in new scripted content shows a rapid decline of usage between the second and third month in what was described as a 'decay curve'. Viewers usage of such content would appear to near zero by month six.⁴²

6.22 Pact believes that these numbers are very low, considering the scale of the BBC's planned changes and expressed aim of re-connecting the BBC with younger audiences. It would indicate again, that content is the driver of viewing and not ease of access to content.

6.23 The BBC concludes that the iPlayer changes are needed because there is "not enough breadth to deliver recommendations – e.g. finishing watching a programme that you have enjoyed, but because there is currently nothing similar available, BBC iPlayer is unable to recommend you anything suitable to watch next."⁴³

6.24 Pact would note that this actually confirms Pact's view that the BBC is not facing a distribution issue but a content problem. The minimum 12 months iPlayer window availability won't deliver content recommendations if the content people want to watch hasn't been commissioned. The BBC confirms in paragraph 73 of their Public Interest Test document that one of the main audience frustrations with iPlayer is the lack or volume of content for particular individuals. Pact believes that this is particularly the case with younger audiences who prefer the content of SVODs.

Competition and the Lack of Additional Public Value

6.25 The BBC concludes that "“We find no evidence that our changes risk crowding out competition. Frontier Economics' report finds that the proposals may result in a small decrease in viewing for some of our competitors – potentially up to a 3.4% loss in viewing for other broadcaster video on demand (BVOD) services – when compared to what would happen if we do nothing. This could in turn have a very small impact on the profitability of these competitors' services, but not at a level which risks crowding out competition or has a significant adverse impact on the market.”⁴⁴

6.26 Pact would query all these conclusions for the following reasons:

Viewing

6.27 Pact believes that the BBC research and analysis doesn't take into account the loss of viewing for individual BVOD services. It states the loss is 3.4% but this would

⁴² Communications Chamber, Forecast of the viewing impact of proposed changes to BBC iPlayer, 2019, p10, figure 6

⁴³ BBC iPlayer Public Interest Test, April 2019, p21, paragraph 67

⁴⁴ Frontier Economics, Changes to BBC iPlayer: competition assessment, April 2019, p11, paragraph 34

be the average when all of them are taken together. It's likely that the impact would be far greater on some BVODs than on others, especially as the BBC are targeting the 16 – 34 age group.

6.28 The Frontier Economics report noted that only 1.5% SVoD users, who were unprompted, stated that they would cancel particular SVOD subscriptions. For Netflix, this figure was only 0.8% whilst Amazon was 1%.⁴⁵ Pact believes that these figures are so low because users take out paid subscriptions to SVOD services because of the quality of content on offer rather than because users are denied long term access to particular BBC programmes on the free iPlayer.

6.29 Pact notes from the Frontier Economics report that All4 and ITV Hub are popular with younger viewers. It is also noted that these services as well as the SVODs are the main competition to the BBC iPlayer.⁴⁶

6.30 Considering the lack of impact on SVOD subscription rates – as stated above – Pact concludes that the BBC will increase their share of the VOD market at the expense of the commercial PSB online services. This is borne out by Figure 22 in the Frontier Economics Report which indicates that My5 will show the greatest drop of usage by viewers with All4 in third place behind Now TV.

6.31 From this evidence, Pact believes that the BBC are under-stating the likely harm to the commercial PSB's services viewing figures from the BBC's planned iPlayer changes. Pact believes that this impact alone means that the BBC's planned iPlayer changes fail the additional Public Value test.

Revenues

6.32 In terms of the loss of revenues, Pact notes that the Frontier Economics report reported on the impact on the revenues of both the commercial PSBs and the SVODs from 2019-2024. By combining the totals of the BVODs loss of revenue and the impact on linear, Pact notes that ITV will see a revenue drop of £63.1 million, Channel 4 - £32.3 million and Channel 5 - £16.6 million. This is a total commercial PSB loss of £112million. Sky would see a £10.5 million linear TV advertising loss.

6.33 This comes to a total cost for the commercial PSBs and Sky of £122.5 million.⁴⁷ Pact notes that the BBC graphs and tables are conservative and smoothed into a steady progression over time. Pact believes that markets often change more rapidly. This could mean for example, Channel 4 experiences serious drops in their viewing figures and subsequent advertising revenues in a shorter period.

⁴⁵ Frontier Economics, CHANGES TO BBC IPLAYER Competition assessment', Figure 37)

⁴⁶ Frontier Economics, Changes to BBC iPlayer: competition assessment, April 2019, p48, figure 20

⁴⁷ Frontier Economics, Changes to BBC iPlayer: competition assessment, April 2019, p9 (figure 2) and p12 (figure 7)

6.34 Pact notes that the SVODs will also see a major reduction in revenues because of the BBC's planned iPlayer changes. Frontier Economics notes that Netflix will lose £105.7 million between 2019-2024 with Amazon Prime losing £75.7 million and Now TV £42.7 million. The cumulative total for these SVODs over this period is £224.1 million.⁴⁸

6.35 Considering that the commercial PSBs are facing considerable challenges from online advertising and the proposed HFSS pre-watershed advertising ban that could cost the TV ad market some £200 million, the BBC's planned changes will have a material impact on BBC's competitors' revenues and reduce incentives to invest.

Investment

6.36 Pact is concerned that this loss of revenue will lead to a reduction in content investment from the SVODs and the commercial PSBs. The PSBs have accounted for 80% of total commissioning spend over the last six years. The SVODs commissioning of content from the independent production sector has reached a minimum of £150 million in 2017 and Pact expects that this figure will have risen in 2018.

6.37 Pact is particularly concerned that that the impact of the BBC's changes may affect the commercial PSBs especially Channel 4's ability to satisfy their Ofcom obligations such as the 'Out of London' production spend quotas which promises to deliver greater economic growth in the Nations and Regions.

7.1 Are there any impacts on public value that have not been identified by the BBC? Please provide evidence to support your views.

7.2 Pact cannot comment on any additional impacts on public value or provide any evidence due to the time constraints of this two-week consultation.

8.1 Do you agree with our approach to reviewing the BBC's assessment of public value generated by the proposals? Please provide evidence to support your views?

8.2 Pact is unable to comment on Ofcom's approach to reviewing the BBC's assessment of public value as the consultation two-week deadline means that it is impossible for Pact to conduct its own surveys or undertake research on public value. This means that it is impossible for Pact to offer evidence with regards to this question.

9.1 Do you agree with the concerns that we have set out in Section 5, or are there any others that we should consider? Please provide relevant evidence to support your views?

⁴⁸ Frontier Economics, Changes to BBC iPlayer: competition assessment, April 2019, p11, figure 5

9.2 Pact agrees with the inclusion of a) Impact on rivals' viewing reduces investment and b) Less BBC content on other platforms as material matters for the market impact assessment. Pact believes that the issues of c) Reduced value of secondary rights d) Unfairly favour BBC Studios should be included as important issues of material impact and so factored into Ofcom's market assessment.

9.3 Pact believes that the conclusions expressed in the BBC Public Interest Test submission and the lack of accompanying empirical data for independent stakeholder analysis means that Ofcom should factor in the following additional evidence.

9.4 For a full assessment of the full market impact of the BBC's planned iPlayer changes, please see Annex A. This is a separate attachment to the Pact submission and comprises of an O&O report which is entitled 'Proposed changes to the BBC iPlayer: Supporting Pact's response to Ofcom's call for evidence'.

Favouring BBC Studios (d) – Ofcom numbering)

9.5 Pact is concerned that the BBC's decision to merge BBC Studios with UKTV will create a vertically integrated company that will be subsidised with advertising revenues from UKTV's multi-channels. This means that BBC Studios will be in a financial position to forego secondary rights revenues as UKTV will provide the BBC commercial subsidiary with ongoing advertising revenues. The relationship between UKTV, BBC Studios and the issue of the iPlayer changes are reviewed comprehensively in Annex A.

9.6 Pact is concerned that BBC Studios' advertising revenues will skew competition as smaller independent production companies in particular won't be able to forego secondary and international revenues and won't be in a position to compete for BBC commissions that include the 12 months minimum exclusive iPlayer window.

9.7 For a full assessment of the full market impact of the BBC's planned iPlayer changes and the likely benefits for BBC Studios, please see Annex A and the attached O&O report.

Impact on Rival's viewing figures reduces investment

9.8 Pact reviewed the cumulative impact on the commercial PSBs and their BVODs and found that the BBC's changes will cost the commercial PSB system £112 million over the next five years.

9.9 Pact is concerned that this reduction in revenue, along with the threat from a watershed ban on Foods High in Fat, Sugar and Salt (HFSS) advertising, will bear heavily on Channel 4 whose BVOD service is likely to be targeted by the BBC due to their wide reach amongst the key 16-34 age group⁴⁹. Pact believes that this will

⁴⁹ Frontier Economics Report- Competition Assessment, Figure 20

impose great pressure on Channel 4 at a time when it is expected to increase its Out of London production spend to 50% over the next few years and is facing a challenging advertising market.

Reduced Value of Secondary Rights and Impact of iPlayer Extension

Under this section, Pact has broken down its evidence into the following sections:

a) Overview of Importance of Secondary Rights

b) Impact on Small/Medium Sized Companies and Children's Content Producers,

c) Link between UK Secondary Rights Values and Impact on Foreign Sales

d) Reduction of UK Secondary Rights Values and Relationship to Primary UK Commission Values

e) The Importance of Exclusive Windows of Content Use

f) Likely Harms to Production Quality and its International Consequences

g) Terms of Trade, Negotiation and Buyers' Power

h) Loss of IP Ownership: Reduction of Investment or Market Exit

a) Overview of Importance of Secondary Rights

9.10 Due to the absence of data evidence for either the assertions made by Frontier Economics or the BBC, Pact remains concerned that the BBC's planned changes pose a severe risk to the UK production and financing ecosystem that has enabled the UK independent production to reach revenues of £2.7 billion in 2017.

9.11 Pact commissioned independent media consultants O&O to undertake an impact assessment of the BBC's planned extension of the iPlayer window to a minimum of 12 months. These findings were included in a preliminary O&O report which has been submitted to Ofcom. For a full assessment of the full market impact of the BBC's planned iPlayer changes, please see Annex A. This is a separate attachment to the Pact submission and comprises of an O&O report which is entitled 'Proposed changes to the BBC iPlayer: Supporting Pact's response to Ofcom's call for evidence'.

9.12 With increased uncertainty around what secondary rights are worth, distributors and banks may be less willing to provide production advances in order to make up the financial gap between the tariff that the BBC provides for the commission and the actual cost of the programme or series.

9.13 For the financing of first-run series, the value of international and UK secondary rights is uncertain because the programme has never been aired to the audience. It

is thus up to the market and distributors to determine its likely sales. These likely sales and future revenues are educated guesses by the distributor but are vital to the production company for it determines the advance that the distributor will give to the production company in return for the right to sell the programme's international and UK secondary rights on the market.

9.14 International rights are most valuable for particular genres such as high-end dramas, natural history and factual formats. For other genres, the international value is determined by the content of the programme. This means that documentaries that cover a particular UK subject may have minimal international value but do have secondary UK rights value.

9.15 Distributors base their investment decision (advance) on a number of complex factors. These factors range from the past record of the programme team, recent sales of that genre, extent of the time delay between the PSB's use of the content and international/UK secondary market use. This is a judgement decision by the distributor, so each interested distributor will offer a different amount as the advance. The production company will choose the advance that best bridges the gap between the BBC tariff (budget contribution for primary rights) and the actual cost of the programme. This means that the Frontier Economics assessment and modelling of the market is flawed and fails to take into account the actual reality of the market. This undermines all the BBC's assertions on the commercial impact of their proposals.

9.16 O&O found that the current model benefits both the independent production sector and the BBC:

- The current model means that the BBC is no longer required to fully fund their programme or series commissions but instead provides a tariff for a licence to broadcast to the independent production company. This tariff ranges from 20 to 100% of the budget. The BBC provides 100% of the budget for those individual programmes or series that have no secondary rights value in the market.
- Under the Terms of Trade agreed between the BBC and Pact, the BBC takes a number of primary rights to the commissioned programme or series which means that it enjoys the first right to broadcast or stream the programme or series.
- The BBC also receives a percentage of the programme or series secondary rights sales throughout the whole of the licence fee period. These revenues will be lost to the BBC if the planned changes to the iPlayer window is put to in effect.
- Under the Terms of Trade agreed between the BBC and Pact, the producer can sell their remaining or secondary rights for a programme or series to a

distributor, or distributors, in return for upfront cash advance(s). This revenue means that the producer is able to complete the budget needed for the programme or series. The exploitation of secondary rights can also provide producers with ongoing revenue streams which can be used to cashflow their company's investment in the development of new IP.

- Under both of these market financing models, the BBC enjoys the full upside of choosing the best of the new IP to commission to series without the considerable expense and risk of funding IP development. This in turn frees up more of the BBC's revenues to be spent on actual content for licence fee payers.
- Under this model, the BBC also gets the full value of their commission at a fraction of the real cost. These reduced costs enable the BBC to provide a much wider range and quality of content than would be possible from the BBC's current revenues.
- Under this market-driven model, independent production companies are able to access the full market value of their series and programme commissions that can range from zero to millions of pounds for a hit show. These financial rewards provide successful producers with the financial means and independence to invest in project development, talent deals and other creative business costs.

Likely consequences of 12 months minimum iPlayer window:

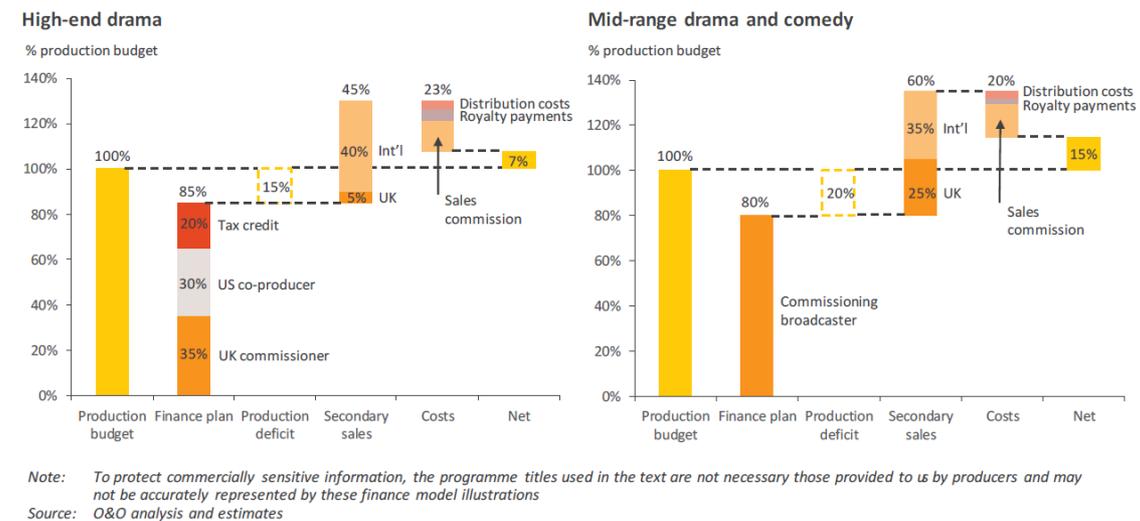
9.17 The O&O market impact assessment has established the implications of the BBC's planned changes to the UK production and broadcasting ecosystem. These implications and Pact's resultant concerns are outlined below:

Detriment to independent producers:

Financing:

9.18 The O&O table below illustrates the importance of secondary rights sales to the independent production sector's ability to complete the necessary finance for their productions. The table focuses on the illustrative finance models for scripted content.

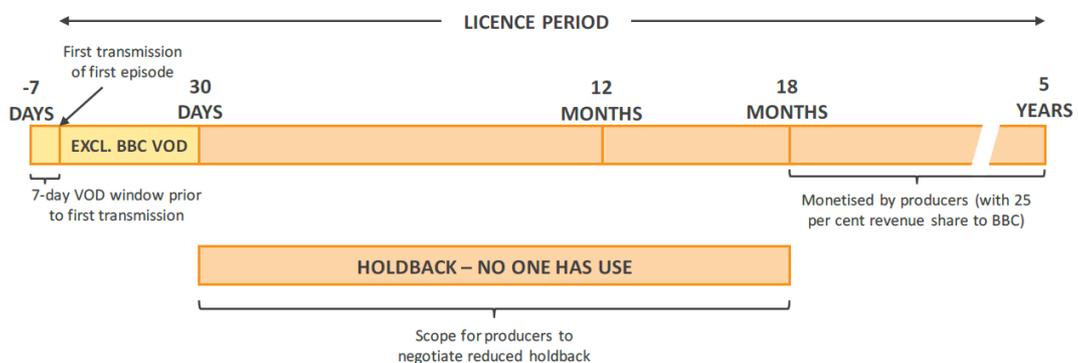
Figure 3: Illustrative finance models for scripted content



9.19 The importance of secondary sales has been exacerbated in recent years as producers are increasingly required to deficit finance productions due the decline in value of the BBC tariff to the overall budget. In some cases, independent production companies are required to relinquish their production fee and thus rely solely on secondary rights for their return on investment.

9.20 The O&O table below illustrates that the current BBC iPlayer window of 30 days enables independent production companies and the BBC to exploit the secondary rights as little as a month after the series has been broadcast. This maximises the value of secondary rights sales as distributor advances, amongst other factors, are based on the length of the BBC’s exclusivity and holdback windows. The early release of content to the market benefits both the BBC and the independent production company for both share the secondary rights sales revenue.

Figure 1: Indicative timeline for BBC Terms of Trade: all series/BBC3/BBC4

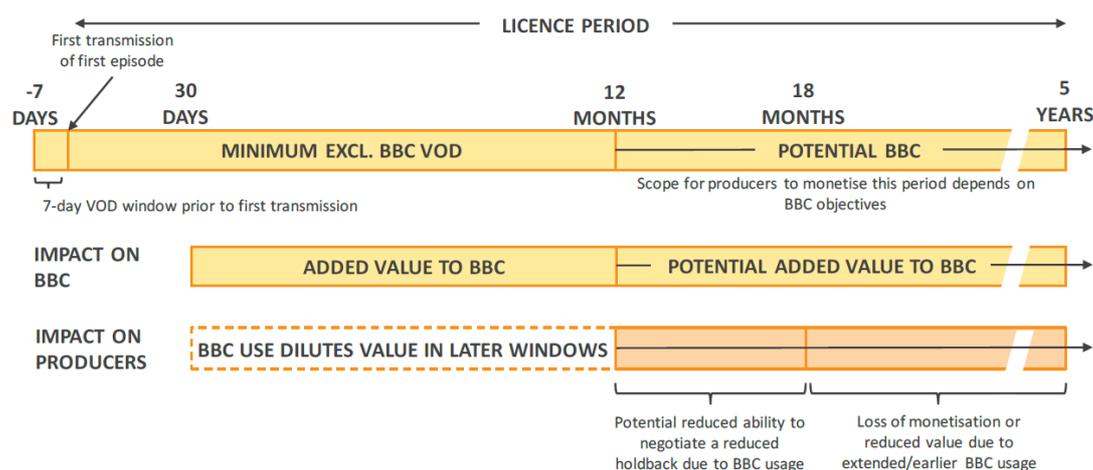


Note: Indicative timeline for a series on BBC. Note that the holdback period for a single programme is six months from first transmission, versus the 18 months from first transmission of last episode of a series, depicted here. Varies programme to programme.

9.21 As shown in the O&O table below, the proposed extension would reduce the value of secondary rights sold. Any loss of revenue from UK secondary rights sales

may reduce the potential for international sales. Under this scenario, independent production companies would find it much harder to complete their production financing because the secondary rights value would be so much less – if not zero - to the secondary financing marketplace. This will make it harder for producers to cashflow their productions and possible even prevent programmes from being made.

Figure 5: Monetisation windows at threat



Note: Indicative timeline for a series on BBC. Note that the holdback period for a single programme is six months from first transmission, versus the 18 months from first transmission of last episode of a series, depicted here. Varies programme to programme.

9.22 The BBC will also have to compensate independent producers for the loss or decline of international and UK rights sales revenues as a result of the planned window change. This will have a detrimental impact on the independent production sector as the BBC will seek to net off their payments for extended rights to the content. This will reduce still further the independent production companies' revenues from the exploitation of their IP or deny them the means to raise investment and benefit from their content's success.

9.23 Detriment to the BBC:

- The BBC will lose their share of secondary rights sales for both the licence period and beyond. This could have an impact on the BBC's revenues and content spend.
- The BBC may also be faced with the prospect of the best UK talent being incentivised to make more expensive dramas so turning their back on the types of programmes that the BBC should be prioritising.

b) Companies Most Affected by BBC Changes: SMEs and Children Content Producers

9.24 The BBC commissions small and medium sized companies more than any other PSBs. In 2017, 25% of the BBC's external spend of £453 million was with the

largest companies whose turnover was over £70 million. In comparison, 52% of ITV's spend was with the largest companies in terms of turnover. The BBC is also the largest PSB commissioner of content.

9.25 This means that the BBC changes will bear most heavily on the small to medium sized companies for whom the BBC is an important source of commissions. Many of these companies are based in the Nations and Regions as 33% of Pact members are based outside of London.

Companies Subset: Impact on Small and Medium Sized Companies

9.26 Empirical research by O&O on behalf of Pact has found that the exclusive 12-month window will inhibit or remove the freedom of independent producers in making commercial decisions about their content. This is because the BBC's 12 months minimum window will foreclose or severely reduce the possibility of secondary UK rights sales for BBC commissioned content. The O&O report found that under the current BBC financing structure, "producers are sometimes required to make no production margin at all and thus rely entirely on secondary sales to make a production financially viable".

9.27 Smaller production companies, which sometimes receive BBC funding for IP development, will be forced to produce the programme at a tariff (budget) level set by the BBC. This is because there will be no or very limited possibility of increasing the budget through secondary rights sales under the 12 months minimum window. Such companies also do not have the equity to raise the programme budget which can improve the programme quality and so boost the opportunities to make international sales.

9.28 Pact notes that the BBC in their Public Interest Test document remains uncertain regarding the cost of their planned changes especially the rise of primary commission tariffs. Under the current BBC financing structure, this ranges from 20% to 100% of the cost of the programme.

9.29 The BBC simply asserts that "any costs associated with the proposed changes would be a very small proportion of the BBC's overall content spend budget for television of £1,612m for 2019/20".⁵⁰

9.30 Pact believes that the BBC has failed to take "reasonable steps" to show that the price for primary commissions will be sufficiently raised – if at all - to ensure that there will be a continued level playing field between BBC Studios and the larger independents. BBC Studios and the larger companies can compensate for lost market finance or specialise in those genres with high international value such as high-end drama. Small and medium sized companies will be obliged to accept the commission on the BBC's terms as there are a very limited number of buyers.

⁵⁰ BBC Public Interest Test submission document, Para 159

A full impact on the SME's is detailed in the Annex A report.

Companies Subset; Children's Content Producers

9.31 Pact notes that the BBC dominates the provision of children's programming in the UK with 95% of PSB spend. The BBC's Public Interest Test submission document states that the BBC intends to make children's content available on the iPlayer for a 5-year period. This is part of the BBC's strategy – as outlined in the BBC Annual Plan for 2019/20 - to move children's content from linear TV onto the iPlayer.

9.32 Under the current BBC financing structure, the BBC only provides 15-25% of the programme's cost to the producers. The deficit financing, which is bridging the gap between the BBC's budget contribution and the actual cost of the programme, is generally achieved by sales of international and UK secondary rights to SVOD providers.

9.33 The O&O market impact assessment for Pact, stated that children's content will be significantly impacted by the BBC's iPlayer changes because key sources of production finance such as merchandising are growing ever more uncertain. Pact believes that the impact of a five-year exclusive window will foreclose any possible secondary rights recoupment. Additionally, secondary UK sales form an important part of the producers' assessment of whether a project is viable or not.

9.34 Pact believes that the BBC's change will result in fewer companies developing children's IP for potential BBC commissions or lead to companies taking their IP directly to other buyers such as the SVODs.⁵¹ Children's content represents a small percentage of commissions in comparison to other genres. In 2017, the value of UK children's commissions was 3% of producers spend.⁵² The market is already small for children's content producers. If children's producer's income is further squeezed by the loss UK secondary rights; smaller companies who do have less capital are likely to suffer.

c) Link between UK Secondary Rights Values and Impact on Foreign Sales

9.35 Pact's evidence is based on the findings of independent media consultants O&O who were commissioned by Pact to undertake an impact assessment of the BBC's planned extension of the iPlayer window to a 12 months minimum window. This involved a survey of Pact's members which range from multi-nationals to small and medium sized companies so the evidence is empirical and market based.

9.36 The O&O report found the following:

⁵¹ BBC Public Interest Test document, para 87

⁵² Pact Census 2018, p20

- The value of secondary rights depends on how new the content is, and to what extent it has been available elsewhere. Exclusive access to content immediately after the initial broadcast is the most valuable to buyers. A sliding scale of value exists as content ages and whether viewers have had the opportunity to watch it on other platforms or channels. The BBC's 12 months iPlayer minimum window will erode or reduce to zero this value.
- With the global SVoDs working hard to differentiate themselves, exclusive access to content is important. They want UK secondary rights as soon as possible, since the UK is an important market where they are seeking to sustain strong subscriber growth. This means that there is significant demand for high-quality UK content, which independent producers can provide in abundance. This sale won't be possible as the BBC's 12 months minimum window or longer will mean that secondary rights won't be available in time for the SVODs.
- The timely availability of UK secondary rights could be the difference between whether or not a (multi-market) deal takes place, or the global SVoD provider is open to a co-production arrangement with the BBC and a UK producer. Global rights with the UK included are much more attractive than global rights excluding the UK. This possibility is excluded under the BBC 12 months minimum iPlayer window.

d) Reduction of UK Secondary Rights Values and Relationship to Primary UK Commission Values

9.37 Independent media consultants O&O found that the production deficit, which is the gap between the actual cost of the series and the actual BBC contribution or tariff, that producers need to cover with secondary sales and other sources of finance has been getting bigger.

9.38 The O&O report noted that producers are seeing their profit margins being squeezed significantly downwards in recent years as "broadcasters have put pressure on content budgets while simultaneously seeking to compete with better funded global services. The new and often complex financial models used to deliver more money on screen at less cost to broadcasters rely on secondary rights sales".

9.39 Pact has established from its member surveys that the BBC's tariffs are on average the lowest of any of the PSBs. This shows that the BBC has expected independent productions companies to seek out financing from the market in return for international and UK secondary market rights. The O&O report noted that "producers are sometimes required to make no production margin at all and thus rely entirely on secondary sales to make a production financially viable". Declining

margins will mean that independent production companies won't be able to invest in IP and innovation which will reduce their competitiveness in the market.

9.40 The O&O report noted that with this "source of income at risk, producers will need to be compensated in some way, or they will be unable to supply the content that they currently do".

9.41 The O&O report, which surveyed UK independent producers, did not find that the BBC were offering higher primary commission tariffs to independent producers in return for an extension of the iPlayer window from 30 days to a minimum of 12 months. The O&O report's summary stated that the "BBC's starting expectation is that the additional content availability will be provided as part of the primary licence, with no additional compensation paid to producers."

e) The Importance of Exclusive Windows of Content Use

9.42 The O&O report outlined the importance of exclusive windows to multi-channel companies and SVODs. It stated that

- Exclusive access to content immediately after the initial broadcast is the most valuable to buyers. A sliding scale of value exists as content ages and whether viewers have had the opportunity to watch it on other platforms or channels. Pact is concerned that the BBC's planned extension of its exclusive VOD rights to a minimum of 12 months will mean that the BBC's content will not be available to other content providers, or services until the value of such content to other providers has significantly declined or been reduced to zero.
- Pact notes that the Ofcom Framework states as an example of the impact of the BBC's distribution of content and services on competition that "content providers and platforms may not be able to develop compelling consumer offerings if they are unable to include BBC content in their services or are given access to it on unfair or discriminatory terms."
- With the global SVoDs working hard to differentiate themselves, exclusive access to content is important. They want UK rights as soon as possible, since the UK is an important market where they are seeking
- Non-exclusive rights would be worth much less to SVOD and multi-channel companies, if they remained interested at all. The marketplace will be distorted because new SVOD or multi-channel entrants won't be able to licence BBC-commissioned content that would enable them to compete with established companies that have the financial means to commission their own content.
- The timely availability of UK rights could be the difference between whether or not a (multi-market) deal takes place, or the global SVoD provider is open to a co-production arrangement with the BBC and a UK producer.

- Global rights with the UK included are much more attractive than global rights excluding the UK.
- Pact notes that foreign broadcasters, as well as SVoD services, may purchase the secondary rights (exclusive broadcast and/or VoD) in international territories. Geo-blocking allows the sale of exclusive rights to particular territories (countries, groups of countries or even continents) to both broadcasters and SVOD services.

f) Likely Harms to Production Quality and its International Consequences

9.43 From the O&O report and Pact's 2018 Census, Pact believes that the changes will lead to the following:

9.44 Reduced access to financing will mean that producers may be forced to produce programmes on smaller budgets. This will have a bearing on the programme's quality and thus the potential competitiveness of such content in the secondary markets.

9.45 This reduction in quality will dilute the UK's record for producing outstanding television for both the UK and international market. This will threaten the sector's outstanding record for the growth of exports and international commissions. In 2017, UK independent production sector achieved £549 million income from overseas primary commissions and international sales of finished programmes of £218 million.⁵³

g) Terms of Trade, Negotiation and Buyers' Power

9.46 For a full assessment of the full market impact of the BBC's planned iPlayer changes in terms of the Terms of Trade and Buyers' Power, please see Annex A. This is a separate attachment to the Pact submission and comprises of an O&O report which is entitled 'Proposed changes to the BBC iPlayer: Supporting Pact's response to Ofcom's call for evidence'. Please also see Annex B for the current VOD under the current Terms of Trade, May 2019 Table. This is also provided as a separate attachment.

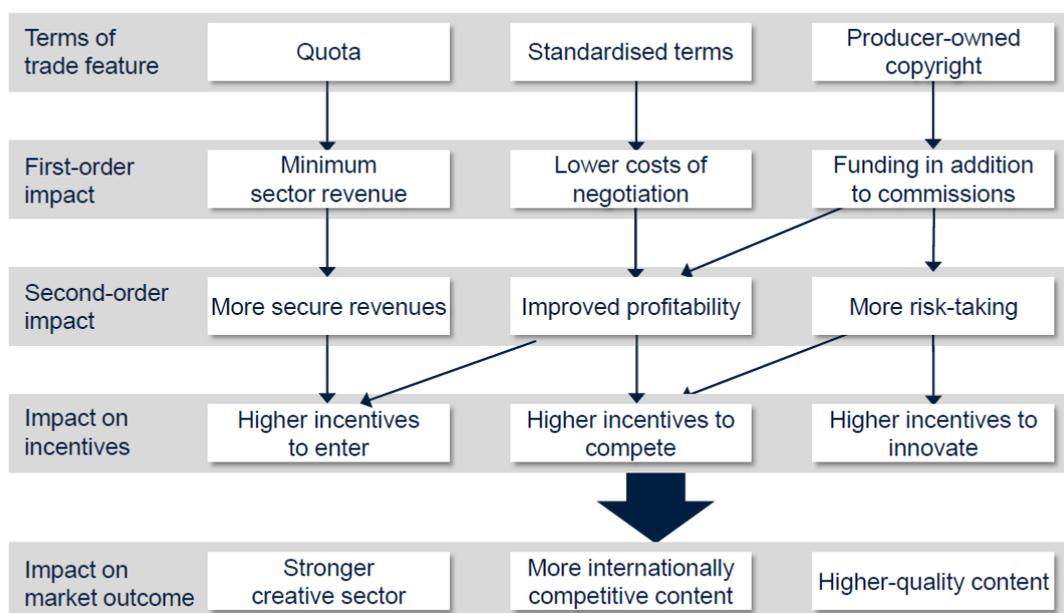
h) Loss of IP: Reduction of Investment or Market Exit

9.47 Pact believes that the BBC's changes will remove the potential of production companies' IP to generate secondary rights revenue and profit from the UK and international market.

⁵³ Pact Census 2018

9.48 The Oxera report ‘Assessment of potential changes to the terms of trade in the independent TV Production sector’ of December 2015 included this ‘Chain of effects’ table which shows how the current financing model and Terms of Trade facilitate the independent production’s sector investment in IP.

Chain of effects of regulatory regime



Source: Oxera analysis.

9.49 Through owning their intellectual property (IP) rights under the current UK production and broadcasting ecosystem, the independent production sector ensures that the market is offered a wide range of ideas (IP) from a large number of participants. Having many organisations pitching ideas to the commissioners makes for a very competitive marketplace and ensures that only the best IP are made available to the audience. The large number of participants has been made possible by the low barriers to entry. Creative talents from either the larger companies or other sectors are able, under this system, to launch their own production companies.

9.50 The dynamism of the independent production sector as a consequence of the large number of SMEs acts as a platform to find and develop new talent both off and on-screen. If the market were to be dominated by a few large players, the number of opportunities for talent to be discovered would inevitably be restricted.⁵⁴

9.51 Under this regulatory regime which rewards innovation and creativity, independent producers are incentivised to invest in IP as the series might prove to be a success and thus ensure a valuable ROI to the production company for a number of years. In addition, the need to sell the content’s secondary rights both in

⁵⁴ ‘UK independent TV production: Engine of growth and renewal: A report for Pact prepared by Oliver & Ohlbaum Associates, November 2015

the UK and internationally means that the producer must deliver content of the highest quality possible. The quality of this content then benefits both the commissioning broadcaster and the UK audience. Ownership of their IP means that independent producers invest in the development and production cycle at several key stages. The first is in research and development (often referred to as R&D). It is extremely expensive, and time consuming to invent, research and develop programme ideas to a stage at which they might be commissioned. R&D was 1.2% of the independent production sector's turnover in 2014 and it was estimated at 1.85% in 2017.⁵⁵

9.52 The media consultancy Oxera reported in 2015 that independent producers develop IP projects with specific broadcasters in mind.⁵⁶ For the significant majority of these projects, the broadcaster declines to take the IP to series which means that the producers often have no or limited options to exploit the developed IP any further. This means that independent producers invest millions of pounds in R&D each year but very little of this is ever recouped in terms of commissions. The investment does, however, bring considerable benefit to the UK PSB ecology in terms of the quality of the IP on offer from the independent production sector.

10.1 Please provide evidence on whether and how the BBC's proposals could directly impact on rivals' viewing, revenues and investment

10.2 Pact is unable to provide evidence for this question. Pact has noted the impact on rival's viewing, revenues and investment from the information supplied by the BBC as part of the Public Interest Test. Pact's view of this evidence can be found in the answer to the question on Public Value.

11.1 Please provide any evidence on whether there might be reduced access to content rights, and whether this might reduce the ability of rivals to compete and why. We would also welcome evidence on the alternative sources of content rivals might consider.

11.2 Pact is unable to provide evidence for this question as it is not been possible in the 2-week consultation period to commission research on this subject

12.1 How do you think that any potential for adverse market impact of the proposals could be reduced?

12.2 Pact would urge the BBC to focus on content and not distribution. The BBC should be concentrating on finding the best IP in the marketplace. The marketplace will then work with the BBC to create content for mutual benefit. The BBC should not

⁵⁵ O&O reported that in the data returns for their 2018 Census (2017 financials), gap financing rose to around £100-110m and R&D to £40-50m. Revenues were at £2.74 billion. The Pact Census of 2015 showed revenues at £2.9 billion with some £35million spent on R&D

⁵⁶ 'Assessment of Potential changes to the terms of trade in the independent production sector: Prepared for Pact', Oxera, December 2015

Ofcom first consultation on proposed changes to BBC iPlayer

close itself off from the market by limiting the possibility of co-productions with the SVODs for example.

12.3 Pact is willing to engage with the BBC to explore what may be an appropriate solution to recognise changing audience behaviour while maintaining maximum levels of investment into PSB programming.

12.4 Pact would reiterate the points made in Pact's response to Section 5.

Annex A:

The O&O report entitled 'Proposed changes to the BBC iPlayer: Supporting Pact's response to Ofcom's call for evidence', May 2019 is provided as a separate document in Pact's submission.

Annex B:

VOD under the current Terms of Trade, May 2019 Table